Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
The Effect of Mobile Termination Rates	)	IB Docket No. 04-398
On US Customers	)	
	)	

COMMENTS OF MCI, Inc.

January 14, 2005

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SUMMARY

Significant decreases in average settlement rates and cheaper rates for U.S. consumers on most of the U.S.-international routes are being increasingly undermined by excessive settlement rates for calls terminating on foreign mobile telecommunications networks. MCI believes that the market structure for termination on mobile networks in countries with CPP regimes has allowed for non-competitive behavior which is, in turn, causing harm to U.S. consumers and competition. MCI estimates that U.S. consumers spend per year on calls to mobile numbers in CPP countries, between $317USD and $408USD million of this is excessive and above any reasonable estimate of cost. If this trend continues, in less than three years U.S. consumers could be paying close to one billion dollars that, in effect, act as a subsidy to foreign mobile operators worldwide. At the same time, despite a low price elasticity, the market structure for international mobile termination to CPP countries results in a situation where actual demand is suppressed by high mobile surcharges, which prevents the market from maximizing its utility.

The key to this problem is that most countries use a calling party pays ("CPP") principle, while the U.S. mobile termination market does not. The CPP methodology is used throughout the European Union, Latin America, the Caribbean and in numerous Asian Pacific countries, including Japan. There may be many advantages to a CPP system, including incentives for increased mobile penetration. One of the side effects of CPP, however, is the potential for above-cost mobile termination rates – if such rates are left unregulated (or insufficiently regulated) – because there is no competitive pressure for MNOs to charge reasonable mobile. Those mobile termination charges are passed on to carriers and, ultimately, to end users. Basic market analysis shows that the mobile termination market in CPP countries is non-competitive, allowing, if not encouraging, higher costs to subsidize the business. Mobile

termination is not, as some of the mobile operators have implied, an amorphous part of the retail market for mobile services. What the mobile network operators offer in the bundle of retail services that they sell to subscribers is not "mobile termination" but, rather, the ability for subscribers to receive calls on their mobile handsets (i.e., access to the mobile network). Defining the market as mobile termination then leads to the conclusion that each mobile operator has full control over the conditions for termination on its network for calls to its own subscribers as there are no viable substitutes on either the demand or supply sides for mobile termination on each operator's network. This provides mobile operators with monopoly power and the result is equivalent to unrestrained monopoly pricing.

The Commission has an impressive history of successful endeavors in the U.S. international telecommunications arena both in the areas of working with other National Regulatory Authorities and in administrative actions and has made significant progress towards its goal of a competitive and market-based U.S. international telecommunication services market. The significant and increasing harm to US consumers and competition as a result of the non-competitive mobile termination market in CPP countries challenges the Commission to rely on its strengths and its jurisdiction and move forward to choose productive and appropriate tools at its disposal to ease the problem before it does any more unnecessary harm to the consumers and the international telecommunication market.

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COMMENTS OF MCI, Inc.

I. Introduction

MCI, Inc. ("MCI") hereby submits Comments in response to the Commission's Notice of Inquiry ("NOI") in the above-referenced proceeding. MCI commends the Commission for recognizing the increasing importance to the international telecommunications market of mobile termination issues while being sensitive to the complexity of those issues. The Commission has an impressive history of successful endeavors in the U.S. international telecommunications arena both in the areas of working with other National Regulatory Authorities and in administrative actions and has made significant progress towards its goal of a competitive and market-based U.S. international telecommunication services market.

In the proceeding that lead to this NOI ("ISP Proceeding"), the Commission addressed its international settlements policy, in general, and made many significant changes to its rules and policies in an effort to ensure that government regulation maximized the ability of companies to participate in competitive markets with minimal burden or intrusion. In the Report and Order from that proceeding ("ISP R&O") the Commission emphasized that it sought to promote competition in international services by encouraging more cost-based international settlement rates. The Commission correctly noted that liberalization in foreign markets and its Benchmarks Order have led to significant decreases in average international settlement rates paid by U.S. carriers.[1] Such significant decreases in average settlement rates and cheaper rates for U.S. consumers on many of these routes, however, are being increasingly undermined by excessive settlement rates for calls terminating on foreign mobile telecommunications networks.

In the ISP proceeding, the Commission considered issues raised with regard to international mobile termination in countries with CPP regimes. It stated that, "We believe that where rates for foreign mobile termination applied to U.S.-international traffic are excessively high, they should move towards cost. . . The Commission's long-standing goals regarding rates for termination of international communications apply to foreign mobile termination rates. As we found with regard to fixed rates, policies based on these goals act to ensure the public interest benefits of more efficient competition and more cost-based calling rates to U.S. customers."[2] Consequently, in an effort to expand its record, the Commission committed to this NOI.

The Commission states in the NOI that it is soliciting information and analyses on mobile termination arrangements and foreign mobile termination rates and on actions taken by foreign national regulatory authorities with respect to these rates in order to better understand whether U.S. customers have adequate alternatives with regard to foreign mobile termination rates and surcharges, and whether such charges raise consumer concerns. The Commission also seeks

[1] *International Settlements Policy Reform, International Settlement Rates*, IB Docket Nos. 02-324 & 96-261, First Report and Order, FCC 04-53, ¶¶17-19 (2004) ("ISP R&O").
[2] ISP R&O ¶ 91.

comment on the impact of these rates and actions on competition in the U.S.-international telecommunications market and, in particular, on U.S. telecommunications services customers.[3]

While many of the Commission's existing policies have protected U.S. consumers from actual and potential harm "caused by instances of insufficient competition in the global telecommunications market,"[4] MCI believes that mobile network operators ("MNOs") in many foreign markets have taken advantage of the market structure allowed by Calling Party Pays ("CPP") regimes to maintain international mobile termination rates at levels far above cost. As explained herein, MCI believes that the market structure for termination on mobile networks in countries with CPP regimes has allowed for an anti-competitive situation which is, in turn, causing harm to U.S. consumers and competition. As a result, MCI believes that the Commission has an obligation to work with industry and foreign governments to find solutions that alleviate the growing harm.

MCI operates in more than 65 countries, and possesses one of the most expansive, wholly owned Internet Protocol networks in the world. MCI has commercial relationships with many international telecom operators and distributors in non-U.S. markets. In addition, MCI has negotiated bilateral agreements with international carriers in 222 countries, and manages more than 67,000 international voice circuits worldwide.

II. Commission's Jurisdiction and Standard for Action

In the ISP Reform Order, the Commission reemphasized its position that it has "broad authority to protect U.S. consumers from harms resulting from anti-competitive behavior."[5] The Commission has acted repeatedly on this authority by participating in the international arena,

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[3] *The Effect of Foreign Mobile Termination Rates on U.S. Customers*, Notice of Inquiry , IB Docket No. 04-398 , ¶1 (rel. Oct. 26, 2004) ("NOI")

[4] *International Settlements Policy Reform; International Settlement Rates,* Docket Nos. 02-324 and 96-261, Notice of Proposed Rulemaking, FCC 02-285 (rel. October 11, 2002) ("NPRM") at ¶1. ISP R&O, ¶ 90-91

[5] ISP R&O, ¶ 91.

taking strong pro-competitive positions in international fora such as the International Telecommunication Union and World Trade Organization, and working with foreign national regulatory authorities ("NRA"s) to support and encourage independent, transparent, and pro-competitive regulatory environments in other countries. The Commission has also long sought to protect U.S. consumers and the international telecommunications markets in which U.S. carriers participate from the monopoly power wielded by foreign telephone companies more directly through administrative actions. It has exercised that power repeatedly by imposing requirements on U.S.-licensed carriers – whether through the benchmark policies, stop-payment orders, dominant carrier provisions, or affiliate protections. Such action has been upheld by the courts – most recently in the U.S. Court of Appeals for the District of Columbia where the Court noted that "the Commission does not exceed its authority simply because a regulatory action has extraterritorial consequences."[6]

The Commission's statement in the ISP R&O also underscores the standard by which the Commission is committed to action. According to the Commission, its authority is to protect U.S. consumers from 1) harms that result from 2) anti-competitive behavior. Consequently, if parties can show both elements, the Commission will be in a position to take action. While the Commission has highlighted this particular standard in relation to its case-by-case approach, MCI believes that the situation is such that this standard can be met on the broad, market-wide scale, and that, as a result, the Commission has both the authority, and the obligation, to investigate and determine appropriate Commission actions tailored to address the harms and market dynamics in question.

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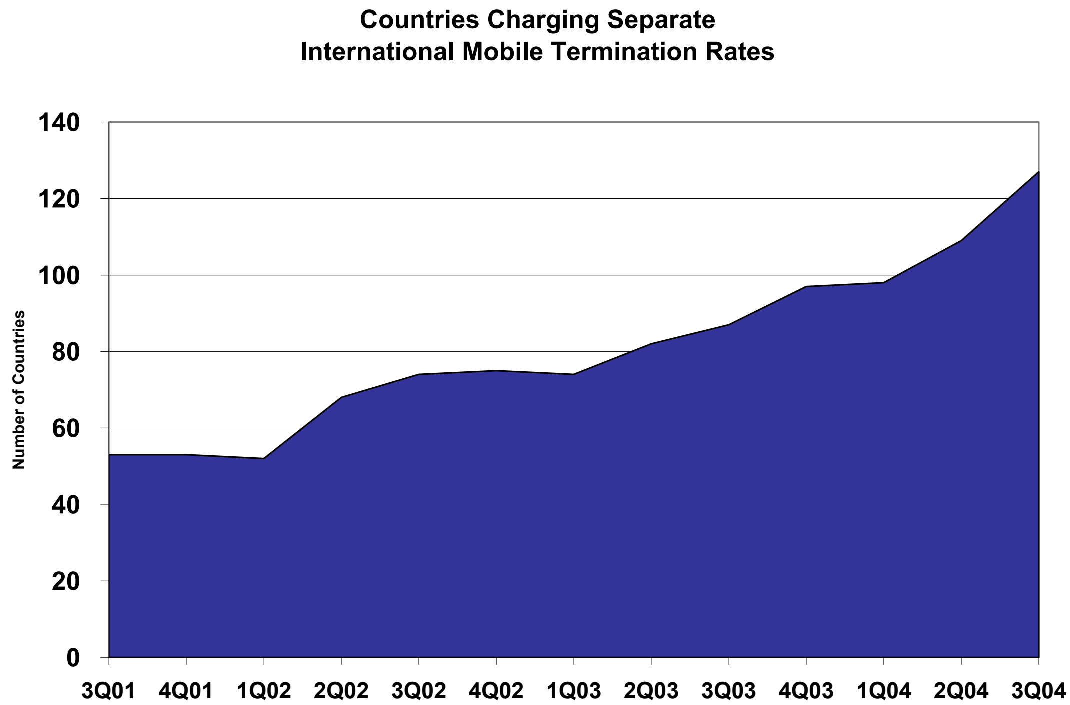
[6] *C&W v. FCC*, 166 F.3d 1224 (D.C. Cir. 1999).

III. High Mobile Termination Rates are a Growing Problem that is Negatively Impacting U.S. Consumers and Competition

U.S. consumers are paying more and more to call abroad as mobile penetration increases steadily and rates for international calls to mobile phones rise dramatically. MCI estimates that the excessive international mobile termination rates cost U.S. consumers and carriers between $317USD and $408USD million per year.[7] MCI analysis also demonstrates that Western Europe is the recipient of approximately 70% of the subsidy paid by U.S. consumers. For example, the transfer of funds to German mobile network operators represents 11% of the total subsidy. The high mobile penetration rates and high volume of calls in this region combined with the excessive level of the mobile termination rates in various countries explain why Western Europe is the major recipient of this inefficient transfer of funds.

MCI is particularly concerned with the trend of mobile termination rates as all elements indicate that this problem will only continue to growth as a result of increasing mobile penetration, mobile substitution, rate increases, and because more new countries are imposing mobile termination surcharges for internationally originated traffic. Indeed, while at the end of 2001 there were only 53 countries imposing separate mobile termination surcharges, today 127 countries impose mobile surcharges. Furthermore, between December 2004 and today Nicaragua, Colombia and Mexico implemented policies to implement or increase mobile termination surcharges.

[7] This estimate was derived using publicly available FCC section 43.61 traffic volume data and an assumption that 25% of global calls terminate on mobile networks, and then by comparing mobile termination rates to existing LRIC cost studies for mobile termination (i.e. what actual mobile termination cost should be).



As illustrated in the table below, if this trend continues, soon U.S. consumers could be paying close to one billion dollars in annual subsidies to foreign mobile operators worldwide. The rapid increase in mobile penetration in all markets, combined with mobile substitution trends, indicate that soon international mobile traffic will match or even overcome international fixed line terminating traffic.

Exhibit E

Table 1

Estimated Subsidy from U.S. to Foreign Mobile Network Operators

Cost Analysis	Percentage of Traffic Terminating in Mobiles Networks	Subsidy to Foreign Mobile Carriers	Note
Sprint PCS	25%	$408,059,764	
	50%	$1,139,398,522	Including Mexico
Analysys	25%	$334,559,397	
	50%	$939,226,164	Including Mexico

Table 2

Estimated Subsidy by Region from U.S. to Foreign Mobile Network

Operators

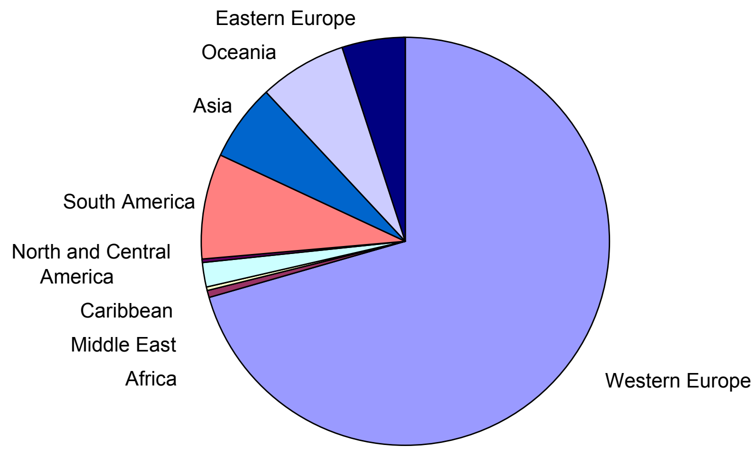
(Based on 25% of traffic terminating in mobile networks)

	Analysys Cost Model	Sprint PCS Cost Model
Western Europe	$ 235,593,576	$ 272,608,136
Africa	$ 2,188,706	$ 4,077,284
Middle East	$ 1,491,932	$ 3,918,155
Caribbean	$ 6,084,886	$ 15,875,767
North and Central America	$ 1,028,399	$ 1,999,364
South America	$ 27,688,460	$ 35,651,679
Asia	$ 20,543,037	$ 26,256,854
Oceania	$ 23,416,867	$ 26,610,233
Eastern Europe	$ 16,522,603	$ 21,061,238
Other Regions	$ 930	$ 1,055
World Total	**$ 334,559,397**	**$ 408,059,764**

Estimated Subsidy by Region from U.S. to Foreign Mobile Network

Operators

(Based on 25% of traffic terminating in mobile networks)



a. *Countries Are Increasing And Or Imposing Mobile Termination Surcharges for Internationally Originated Traffic.*

Foreign mobile network operators continue increasing mobile termination rates. MCI is particularly concerned that in some cases the rate increases have been approved by the countries' regulatory authorities. For example, In Colombia, effective January first mobile termination rates increased by 45%. The increase was approved by the Colombian telecommunications' regulator.

Furthermore, MCI is increasingly concerned about the pattern of behavior whereby foreign carriers demand rate increases unilaterally without efforts at commercial negotiations and often in the middle of the term of an existing contract. Instead, as an indication of the degree of market power they possess, foreign carriers often simply send a notification stating when the new rate is effective. There is no negotiation process and the notification is generally a take-it-or-leave-it "offer." In cases where MCI has refused to accept the unilateral rate increase, carriers threat to block MCI's circuits. In fact, Enitel, the former state owned monopoly in Nicaragua, now controlled by America Movil, blocked MCI's circuits carrying mobile traffic after MCI refused to accept a unilateral rate increase that violated the terms commercially agreed with Enitel. MCI's circuits for mobile traffic have been blocked by Enitel since December 7th, 2004. Despite MCI's best efforts to come to a resolution and MCI's request to the Nicaraguan regulator to intervene, at the time of submitting these comments, MCI's circuits have continued to be blocked.

Of greater concern in terms of size, Mexico, the second largest U.S.-international route is also planning to implement CPP rules for long-distance calls to mobile phones. In a press release issued last month, the Comision Federal de Comunicaciones ("Cofetel") announced that mobile termination charges will apply to both domestic and international long-distance calls. As a conservative estimate, assuming that only 25% of the traffic terminates in Mobile phones in Mexico, implementation of CPP for international originated traffic could cost U.S. consumers more than $248 Million dollars a year.

It is MCI's understanding that Cofetel believes that Mexican immigrants living in the US would be willing to pay higher rates in order to keep in touch with relatives in Mexico and without obliging the latter to pay for the service. This is also the view of some in the financial community, who see in this initiative an opportunity to boost Mexican mobile operators' free cash flow, at expense of U.S. consumers and in particular, the 26 million Mexicans living in the United States[8].

b. Excessive Foreign Mobile Termination Rates Suppress Demand

[8] See, "*CPP expected to boost mobile market" – Mexico,* BNamericas.com, , *December 28, 2004*

Unnecessarily high mobile termination rates suppress demand for fixed to mobile calls -- although this is masked by increasing penetration rates and advancing mobile substitution for fixed, combined with low price elasticity that allow actual volumes to increase. In MCI's experience, there is a two step response by consumers to increases in mobile termination rates. When a separate, higher mobile rate is imposed, volume of mobile termination as a percent of total international termination drops significantly. Volume percentages stay at the lower percentages fairly consistently after that, even when mobile termination rates are increased again, without necessarily returning closely enough to the original levels. This suggests that, despite low price elasticity, actual demand is suppressed by high mobile surcharges, which prevents the market from maximizing its utility.

IV. Harm to U.S. Consumers and Competition is a Result of a Non-Competitive Market Structure and Insufficient Regulation of Players with Significant Market Power

It is evident from the above discussion that there is harm to U.S. consumers and competition. Rates are going up on an expanding section of calls, costing consumers more and dampening their use of a valuable technology and leading to harm in the growth of the international telecommunications market and the health of competition in this industry. If this harm is a result of anti-competitive behavior at any level, the Commission is obligated to look into the situation. MCI recognizes that the Commission has made an effort to investigate all sections of the process through which fees are assessed to identify where the problems lie and supports the Commission's fair and transparent commitment to developing as complete a record as possible. MCI notes, however, that the international transport portion of the process is highly competitive. Anti-competitive behavior in the U.S.-international transport segment of the market would be very difficult to achieve and would require a showing of collusive behavior on the part of the big carriers. On the other hand, MCI submits that there is considerable world-wide agreement that mobile termination in countries with CPP regimes that are unregulated (or insufficiently regulated) is a market that is not competitive enough to act to press rates towards cost. Thus, absent a detailed showing of collusive behavior, the appropriate segment of the charge assessment process to focus on when considering whether competition is sufficient to keep rates close to cost is the mobile termination market.

a. The Calling Party Pays Principle – the critical element

The Commission accurately describes the structure by which agreements are made and payments flow for international calls that terminate on a mobile phone.[9] The key element of that structure, for purposes of this NOI, is that most countries use a CPP principle, while the U.S. mobile termination market does not.[10] The CPP methodology is used throughout the European Union, Latin America, the Caribbean and in numerous Asian Pacific countries, including Japan. There may be many advantages to a CPP system, including incentives for increased mobile penetration. One of the side effects of CPP, however, is the potential for above-cost mobile termination rates – if such rates are left unregulated – because there is no competitive pressure for MNOs to charge reasonable mobile termination charges as the cost of inbound calls is immaterial to the end-user customers. Those mobile termination charges are passed on to carriers and, ultimately, to end users.

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9 NOI at ¶ 3-4.

10 While there are, arguably, some elements of CPP methodology in the U.S. mobile termination market, the specific payment flow and existing regulatory structure combine to result in a significantly different situation than that under discussion in most foreign markets.

This phenomenon has been recognized in almost all countries in which CPP exists. These include the national regulators in Belgium, Spain, France, Ireland, Italy, Sweden, and the United Kingdom,[11] as well as Jamaica.[12] Indeed, in the United Kingdom, Oftel the precursor to Ofcom, the U.K. regulator, found that the choice of a mobile handset and the price of outgoing services are the two most important factors when consumers choose a network, while the rates for calling mobile phones are not a factor at all for most consumers.[13] Oftel also noted that termination charges are typically not listed in advertising material or published on MNOs' websites or in booklets, indicating further that operators do not compete on termination charges when trying to attract new customers. The U.K. Competition Commission, when reviewing Oftel's decision to impose price controls on mobile termination rates, noted that the mobile operators in a CPP system "are monopolists in relation to the supply of termination services on their own networks."[14] The Competition Commission concluded, therefore, that "there are insufficient incentives for the [mobile operators] to reduce such charges and moreover that, in the absence of regulation, there would be incentives for [mobile operators] to increase them."[15] In sum, it is primarily the dynamics of the CPP system that lead to the absence of competition in mobile termination services as we will discuss below, and not the market shares of the operator.

b. Market Definition

The Commission seeks comment on whether a finding that a foreign mobile network operator has market power in a relevant market is a prerequisite for evaluating the

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[11] *See* European Commission*, Eighth Report from the Commission on the Implementation of the Telecommunications Regulatory Package*, COM(2002), December 12, 2002 ("*8th Implementation Report*") at 22-23.
[12] *See* Jamaica Office of Utilities Regulation, *Consultative Document on Dominant Public Voice Carriers No. 2*, November 2002 (concluding that "all mobile carriers are dominant with respect to the termination service offered" and "the OUR is of the opinion that … there is a separate market for terminating calls on each mobile network.")
[13] *See Oftel Mobile Consultation*
[14] UK Competition Commission, *Mobile Phones Inquiry*, Remedies Statement, July 23, 2002 [*hereinafter* Mobile Phones Inquiry] (available at http://www.competition-commission.org.uk/pressreleases/39-02REM.pdf), at 4.
[15] Id.

reasonableness of mobile termination rates.[16] If so, it asks, which market definition is most appropriate, and it is possible, as a practical matter, to evaluate the competitiveness of the mobile sector of the 161 countries that currently have mobile termination rates?

Although the Commission's administrative prerequisites differ from other regulators, such as those in Europe, a determination of the market definition and an assessment of the market power of the network operators, are, in fact, critical elements in evaluating whether mobile termination rates are vulnerable to abuse by MNOs. This is not the first time that the Commission has focused attention on the issue of terminating access. As the NOI notes, "the Commission has previously noted the unique difficulties presented by the case of terminating access, where the called party is the one that chooses the access provider, but does not pay the provider's terminating access service charge.[17] In the context of the domestic wireline local exchange market, the Commission found that "once an end user decides to take service from a particular LEC, that LEC controls an essential component of the system that provides interexchange calls, and it becomes the bottleneck for interexchange carriers that wish to complete calls to, or carry calls from, that end user."[18] The Commission concluded that this market structure, combined with other factors, enabled competitive local exchange carriers to "impose excessive access charges."[19] The question of the mobile termination market in CPP regimes is a parallel investigation that leads to parallel results.

[16] NOI at ¶ 35.

[17] *Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket 92-262, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923, 9934-935, ¶ 28 (2001) ("*Access Charge Reform Order*"); *see also Petitions of Sprint PCS and AT&T Corp. for Declaratory Ruling Regarding CMRS Access Charges*, WTB Docket No. 01-316, Declaratory Ruling, 17 FCC Rcd 13192, 13196-197, ¶ 10 (2002).

[18] *Access Charge Reform Order*, 16 FCC Rcd at 9935, ¶ 30.

[19] *Id.* at 9935-936, ¶ 31.

Several operators have argued that the "mobile sector" is vigorously competitive.[20] They fail to distinguish, however, between the retail market for mobile services, for which there may be several competitors, and the wholesale market for mobile termination, for which each mobile operator holds a monopoly. Mobile termination is not, as some of the mobile operators have implied, an amorphous part of the retail market for mobile services. What the mobile network operators offer in the bundle of retail services that they sell to subscribers is not "mobile termination" but, rather, the ability for subscribers to receive calls on their mobile handsets (i.e., access to the mobile network).

Mobile termination is something inherently different: it is a wholesale service offered to telecommunications operators as an input into their own retail products. A bundled product market can only exist when buyers purchase the products together and when there is a close functional correlation among these products. This is not the case for mobile termination because the buyers are at a different level of trade than those purchasing retail mobile services. Termination on each individual mobile network is a separate market because the calling party cannot choose which network on which to terminate calls. The market for mobile termination therefore should be defined at the individual network level, not as a market for mobile termination comprising all MNOs.

Notably, a number of regulators in Europe – including, for example, the UK, Sweden, and the Netherlands – have concluded that the relevant market definition for analyzing mobile termination charges should be the market for terminating to mobiles on individual networks.

[20] *See* Comments of Verizon, Inc., in *In the Matter of International Settlements Policy Reform*, U.S. FCC IB Docket No. 02-324, at 8; Comments of Asociación Nacional de Industrias Electrónicas y de Telecomunicaciones, or "ANIEL," at 6 (filed January 14, 2003) ("ANIEL Comments").

Moreover, the European Commission issued a Recommendation in which it identified a separate market for mobile termination on single networks for purposes of ex ante regulation.[21]

Having established that the market for the provision of mobile termination must be defined independently and not in conjunction with other mobile services, the relevant question is what is the appropriate market definition. Mobile call termination is the service provided by the MNO serving the recipient of a call, to the (fixed or mobile) network operator of the subscriber who originated the call. It is clear that this service is a wholesale service, i.e., a service that is either resold or utilized as an input for the provision of downstream services. The competitive relationship open for analysis, therefore, is the one between the network operator demanding mobile termination and the network operator supplying mobile termination. More precisely, the question is whether, following a small but significant non-transitory price increase in termination rates:

- Network operators demanding mobile termination could react by substituting mobile termination with another service (demand side substitutability), or
- Other MNOs could offset the price increase by offering mobile termination on their own networks (supply side substitutability).

In MCI's view, other considerations, such as the degree of competitive pressure arising from potential substitution at the retail level, do not necessarily impact market definition at the wholesale level. Such considerations relate more to the market power analysis that, logically and analytically, is part of a separate exercise. However, for the sake of completeness, we will also consider these issues.

i. Demand Substitution at Wholesale and Resale Level

In order to assess the existence of demand side substitution, one needs to consider whether there is any substitute for termination on a given mobile network. Key to the analysis is the fact that to be a credible public network operator, a carrier must be able to offer retail customers the ability to reach any other user connected to any other public network. In order to do so, network operators need to be able to purchase termination services from all the other operators running public networks (including MNOs). It is evident, therefore, that there cannot be any substitute for mobile termination on each individual network.

There is also a lack of demand-side substitution at the retail level, because the calling party has no choice regarding which mobile network he or she is calling. The only option is to reach the called party on the mobile network to which the called party has chosen to subscribe.

Where the calling party pays, there is no evidence that the parties responsible for choosing mobile networks (i.e. retail subscribers to mobile services) take into account the prices of incoming calls. Therefore, there is no competitive pressure for MNOs to lower mobile termination charges.

Also, there is no evidence of substitutability between different types of calls. Calls to fixed lines are not seen as an adequate substitute for calls to mobiles in view of their different functionalities. Nor are mobile-to-mobile calls effective substitutes for fixed-to-mobile calls. First, off-net mobile-to-mobile calls are not effective substitutes because the terminating MNO still controls the termination charge for off-net mobile calls. Moreover the scope for on-net mobile-to-mobile calls to serve as a substitute is inherently limited because it requires that calling and called parties subscribe to the same mobile network. In any event, increasing the number of on-net mobile-to-mobile calls has no downward effect on the termination charges for off-net mobile-to-mobile calls and fixed-to-mobile calls.

Similarly, other services such as call-back,[22] voicemail, SMS and paging[23] have not proven to be effective substitutes for mobile termination, and will not be in the foreseeable future.

Another potential, but not effective, demand substitute is the closed user group (CUG), where mobile users are part of an economic or social group such as a company, family, or circle of close friends. Because each member of the group calls other members frequently, there may be some price sensitivity among those users to the price of mobile termination. This sensitivity does not, however, impose a constraint on MNOs' ability to set termination charges because MNOs are able to price-discriminate in favour of CUGs in order to segment price-sensitive customers and thereby maintain high wholesale charges for other terminating access services. For example, MNOs use cross-subsidised "on-net" calling rates and mobile VPN services to address the price sensitivities of CUG members. Therefore, CUGs are not an effective substitute for mobile termination..

ii. Supply Side Substitution at the Wholesale and Retail Levels

In order to assess supply-side substitutability at the wholesale level, it is appropriate to examine whether alternative suppliers are available for mobile termination services when prices

[22] Call-back occurs when the direction of a call to a mobile subscriber is "reversed," either by technical means or in an ad hoc manner through agreement by the called and calling parties, to take advantage of the fact that retail origination charges are lower than termination charges. Oftel, for example, has examined whether the practice of call-back is having a constraining effect on mobile termination prices and has found that there is no evidence of commercial offers of call back in the market. Moreover, the use of ad hoc call back as a substitute is likely very minimal due to the inconvenience of setting up such calls and the fact that the called party has little incentive to pay for a call that would otherwise be the responsibility of the calling party.

[23] Voicemail, SMS, and paging are not effective substitutes for mobile termination. The primary utility of each of these services is to send a brief message. They do not enable practical real-time conversation or permit the ease of conversation characterized by a telephone call. SMS is an imperfect substitute for voice because it has its own language and symbolism and does not take place in real-time. SMS tend to consider text messages as a service that is additional to, rather than a substitute for, voice calls.

are high. There are no supply side substitutes for mobile termination services by a given mobile operator. This is because it is impossible to substitute call termination on one network for termination on another network, because calls to a particular mobile user must be terminated on the network to which that user has subscribed.

A certain degree of supply side substitutability may theoretically occur at the retail level. In theory, an MNO may convince subscribers on competing networks to switch to its network by lowering the rates for call termination on its network. As explained above, however, mobile subscribers generally are not sensitive to mobile termination rates (since they do not pay them except in the CUG example described above) and therefore are unlikely to switch providers on such a basis.[24]

In conclusion, MCI believes that the case for a market definition for mobile termination on individual networks is compelling. Each mobile operator has full control over the conditions for termination on its network for calls to its own subscribers. There are no viable substitutes on either the demand or supply sides for mobile termination on each operator's network.

c. Market Power Analysis

Having established the appropriate market definition, it is appropriate to consider whether mobile operators have significant power in such markets. Given that the relevant market is termination on individual mobile networks and that, by definition, each mobile operator has 100% market share on its own network, the answer to this question seems obvious. MCI, however, believes that market shares are only a proxy for market power and that the assessment

[24] It has also been suggested that multiple SIM phones, which enable users to choose among different mobile networks on a single mobile handset, could create the conditions for supply side substitution. Multiple SIM phones are not an effective substitute for single-network mobile termination for two reasons. First, most handsets are sold with the original SIM card locked in by the MNO, making use of multiple SIMs impossible. Second, even where multiple SIMs are useable, the called party must choose the cheapest terminating network for receiving calls. This raises the very same problem as with the single SIM, i.e., that the called party is sensitive to the price of originating, not terminating, calls on his or her mobile phone. In sum, multiple SIM phones, even if widely available, would have little effect on the rates for mobile terminating access services

must be based on a full competitive analysis. In a context where the operator under scrutiny has a market share of 100%, MCI believes that the factors that need to be taken into account to assess the existence of market power are potential competition and countervailing power. These, in fact, are the only competitive forces that could constrain the market power of a monopolist.

As far as market entry is concerned, it is clear that the market for termination on individual mobile networks is protected by insurmountable barriers to entry. There is no way in which a new entrant could provide termination on a given mobile network.

With regard to countervailing power, it must be noted that - theoretically – buyers (fixed and mobile) of mobile termination could constrain MNOs' market power on termination on their own network. They could do so either by threatening to redirect their demand to a different supplier or they could use access to their network as a bargaining chip.

This, however, does not happen in reality. There are a number of reasons for this, including the fact that fixed operators or other mobile operators are unable to exert countervailing power vis-à-vis a given mobile operator as buyers. The reason for this is that other network operators simply have no leverage, as they cannot shift their demand to an alternative provider. Terminating traffic on the network of mobile operator "A" will not allow an operator to connect its customers to the customers of mobile operator "B", or vice versa.[25] In addition, MNOs are unable to exert countervailing power vis-à-vis other mobile operators as providers of call termination. This is because Mobile Operators do not have any incentive to do so. The high charges they levy for terminating access to their own customers (which they also receive from

[25] The situation would be different if the customers of mobile operator "B" were able simultaneously to receive service from mobile operator "A"; however, existing 2G GSM network architecture, handsets and numbering systems do not allow this possibility; nor are there any foreseeable developments on the horizon that would alter the situation in any material way.

FNOs) is a revenue stream that more than offsets the cost of purchasing terminating access from other MNOs.

High termination charges on any mobile networks result in a substantial competitive distortions, leading to an artificial transfer of resources from fixed networks to mobile networks. In addition to increasing the cost of calling a mobile phone beyond economically efficient values, this results in an artificial diversion of economic resources from other sectors of the economy towards mobile networks. It makes little sense to accept market failures in the name of subsidizing some operators over others, particularly when U.S. consumers and competition will suffer the consequences.

Potential for Price Squeeze

i. Vertical Integration

High mobile termination rates are also likely to give rise to serious competitive distortions. A clear example of such a distortion occurs where, as a result of high fixed-to-mobile termination rates, integrated mobile-fixed operators are able to place fixed network operators ("FNOs") in price squeeze, thereby limiting competition. In brief, it is well recognized by regulators that an entity that is both a supplier and competitor in a market has an incentive to disadvantage its rivals by discriminating in the pricing or provisioning of inputs. An especially harmful form of exclusionary behavior where a firm with market power raises above cost the price of the inputs charged to competitors, while at the same time enjoying lower costs for its own use of the same input. In the case of mobile termination, competitive FNOs may be disadvantaged relative to integrated mobile-fixed operators in the provision of fixed services if such operators set mobile termination rates above cost.

Even if integrated operators may appear to be observing non-discrimination obligations by charging fixed line operations the same above-cost termination rate (and this is by no means clear in the case of bundled services offered to customers), there is a substantial difference in the situation faced by the vertically integrated operator and its competitors. Payments from rivals like MCI to the vertically integrated operator are part of MCI's marginal cost of providing fixed-line services. Payments from a fixed-line player to its mobile subsidiary are internal transfer payments within the same undertaking. Since integrated mobile-fixed operators like Telstra will attempt to maximize overall profits of the undertaking (rather than the profits of each unit identified separately), it is unlikely to treat the internal transfer payment as a true cost in competing in the fixed-line market.

These circumstances enable such operators to place FNO competitors like MCI in a price squeeze, which occurs when the vertically integrated operator's retail price for fixed-line services fails to cover the same costs as an equally efficient competitor would have to cover if it provided the identical service. The result is to limit competition by foreclosing entry by FNOs and deterring their ability to invest in their networks.

The data required to demonstrate this form of price-squeeze is difficult to obtain because price-squeeze often occurs in the most keenly contested markets, for example the high-end corporate sector, where bespoke discounts are common and prices are frequently opaque as a result of bundling. For this reason the only means of reliably limiting the scope for price squeeze by vertically integrated FNO-MNOs and the resulting harm to competition, is to ensure that interconnect rates are cost oriented.

V. Methodology for Evaluating Foreign Mobile Termination Rates

In order to evaluate for itself whether there are excessively high rates that warrant action, the Commission seeks comment on whether it is feasible to evaluate foreign mobile termination rates by employing a LRIC cost standard, or if not, whether some other cost standard would be a reasonable alternative. Several costing principles have been suggested in various fora around the world. These include: Fully Distributed Costs and Average Stand Alone Costs (FDC), the Efficient Component Pricing Rule (ECPR), Ramsey Pricing, and Long Run Incremental Costs plus equi-proportionate markup (LRIC + EPMU) among others. However, as demonstrated by Andersen and other economic studies and discussed in the following section, FDC, ECPR, and Ramsey Pricing present several limitations that generate other distortions in the market. For this reason, MCI supports using LRIC + EPMU using a bottom-up cost model to evaluate foreign mobile termination rates.

a. *LRIC Bottom-Up Model*

Some of the advantages of a bottom-up model include the following:

- It can be achieved without substantial input from the MNOs. In particular, it does not require detailed accounting data to be available.
- It reduces the problem of confidentiality of data. As the model does not model the operator's actual network, the cost and volume inputs can be generically obtained by using generally available information and knowledge about telecommunications network structures.
- It does not require individual analyses of each market with a U.S. route.
- It increases the transparency and objectivity of the cost-calculations. Input data, assumptions and calculations can be scrutinized by both the regulatory authority and perhaps by other operators as well. This may increase other operator's confidence in the model.
- It is easier to build and operate than a top-down model and may be operated without ongoing assistance from the regulated operator. The effect of different assumptions can be quantified and adjustment to data, assumptions and calculations may be made over time.
- It takes account of all theoretically available efficiencies, both technical and operational. This makes it possible to build a network that is optimally dimensioned to the current demand and that uses forward-looking technology.

b. Ramsey Pricing

Some MNOs have argued that even if they are found to have market power for termination of calls on mobiles, the higher charges for mobile termination are competed away through lower prices in the retail origination market. MNOs argue that they are therefore setting economically efficient "Ramsey Prices." This argument is insufficient. First, even if we were to accept the arguments that Ramsey Pricing is appropriate (which we do not), any purported benefits of Ramsey Pricing would depend on the retail side of the market being fully competitive. Otherwise, the above-cost component of mobile termination charges would not be competed away in the other markets. Ramsey pricing requires that the profit constraint (i.e., zero excess profits) be met and not exceeded.[26] In fact, the evidence gathered by different Financial Analysts indicates that the MNOs are earning supra-normal profits.[27]

Second, even if the mobile sector were competitive, the subsidy provided from above-cost mobile terminations to retail services would be economically inefficient. With respect to consumers, it is a key element of the cross-subsidization and Ramsey Pricing arguments of the MNOs that high termination rates do not hurt consumers, because they are balanced by lower rates for other services. Such benefits, however, obviously do not flow to consumers who use only or predominantly fixed lines. Likewise, high mobile termination rates increase the costs of FNOs, which leads to higher retail prices and lower returns on investment as a result of price squeeze. This, in turn, could lead FNOs to reduce their future investments in new and expanded services and facilities. Consequently, MNOs' cross-subsidization arguments are unsustainable

[26] *See* Cave Paper, Section II.

[27] *See* JPMorgan, *Mobile Matters 2002 - Is there an ARPU rebound?*, London, September 2002; Salomon Smith Barney, *European Mobile*, 10 September 2002.

because "the loss of economic welfare suffered by those calling mobiles would exceed the gain to mobile owners."[28]

Third, a socially optimal application of Ramsey pricing requires that prices be set based upon market elasticities of demand for the services used by consumers, something that is economically infeasible. By contrast, MNOs price using the elasticity of demand for mobile termination, which is much lower than the retail elasticity of demand for calls to mobiles. This is because an MNO in the CPP environment does not directly realize any benefits from reduction in the costs of incoming calls.

c. The Efficient Component Pricing Rule (ECPR)

The concept at the root of ECPR, also referred to as the Baumol-Willig rule, is to add an opportunity cost mark-up to the cost of providing the access and interconnection services. Some MNOs have proposed ECPR as the cost method to estimate fixed-to-mobile termination rates. However, ECPR would lead to persistently super-normal rents on a service in which there is no prospect of competition and provide no mechanism for forcing retail rates to competitive levels.

d. Top-Down Cost Model

[28] Andersen Report, at 70.

One of the major problems presented by a top-down cost model approach is that the carrier is responsible for developing it. Historically, the top-down model was embraced by incumbent carriers with a guaranteed rate of return on their "costs of doing business" at a time when they were the only provider of facilities and these facilities were not used also as inputs by competitors. Therefore, the top-down model itself is defined as loading the total costs of the business into the model to produce a rate that fully recovers all costs of the business, not just costs that are explicitly associated with the mobile termination network.

Consequently, MNOs will be in complete control of the development of the model, including selection of which data to use, and defining assumptions and simulations and the resulting price. It is unlikely that MNOs will have the necessary incentive to develop an efficient top-down model that could lead to a reduction in its revenues. Moreover, the MNOs' incentive to delay the model's development, and to use misleading data, is likely to diminish competitors' confidence in the output of the top-down cost model.

VI. Various Evaluations of Cost all Show Mobile Termination Rates far Above Cost

Even without decisions on what model to use, there are a number of approaches that can be taken to gain insight into the degree by which foreign mobile termination rates can be considered excessive. These include a) the difference between the cost of terminating calls on foreign fixed and mobile networks, b) the difference between mobile termination rates across countries, and c) compared with various existing estimates of cost-based mobile termination rates.[29] In some countries the degree of excess is also evidenced by the difference between the

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Analysys cost model developed for OFTEL, Sprint PCS Cost Model. See Section 2 for more information.

price of mobile-to-mobile and fixed-to-mobile calls. We address each of these approaches below.

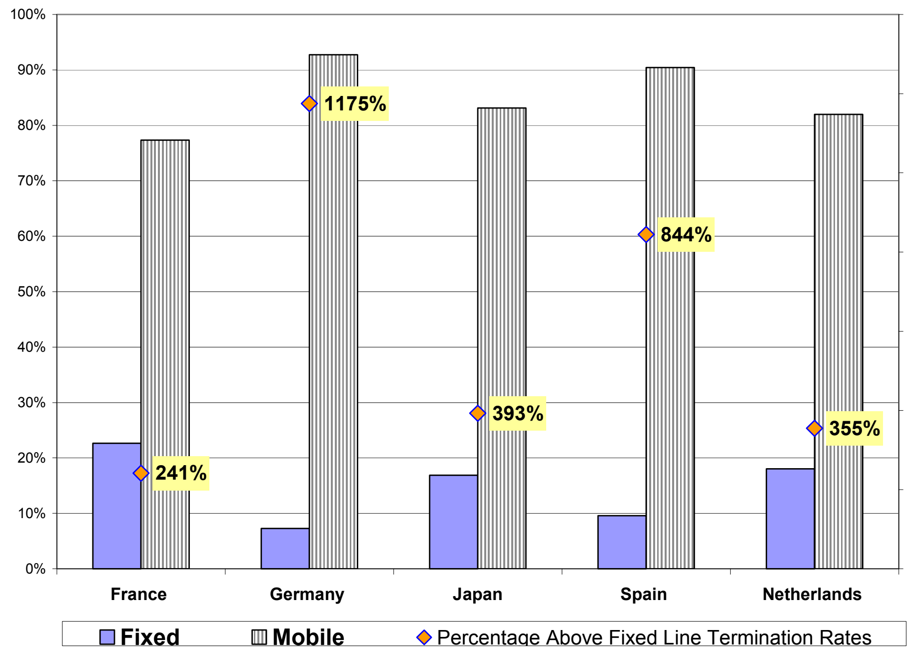
a. Foreign Mobile Termination Rates Far Exceed Fixed Line Termination Rates

The excessiveness of foreign mobile termination rates is evidenced by the disproportionate difference between fixed and mobile termination rates. While the cost of terminating a call in a mobile network might be slightly higher than the cost of terminating a call in a fixed line network, it is unlikely that the cost difference could be several times the cost of terminating a fixed line call. However, as illustrated in the graphic below, foreign mobile termination rates are up to twelve times above foreign fixed line penetration rates. In MCI's experience, MNOs have not justified the disproportionate difference.

Exhibit A

Relative Costs

Foreign Fixed and Mobile Termination Settlement Rates

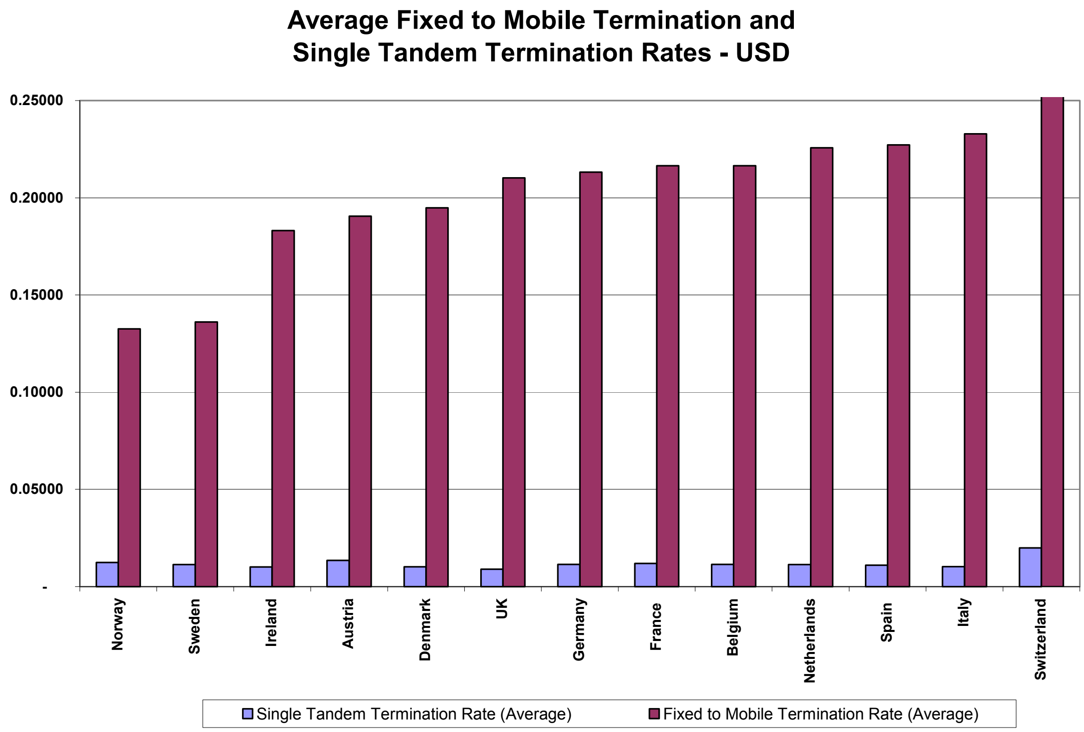


This disproportionate difference is also evidenced when comparing the in-country mobile and local termination rates. As illustrated on the graphic below fixed mobile termination rates are significantly above single tandem termination rates.

Exhibit B

Average Fixed to Mobile Termination and Single Tandem

Termination Rates



Note: Average Mobile Termination Rates reflect the average of peak and off-peak traffic for all mobile operators. Exchange Rate USD-EUR (0.74 –Average December 2004). Single Tandem reflect the average of peak and off-peak traffic.

b. Foreign Mobile Termination Rates in many countries are significantly above best practices

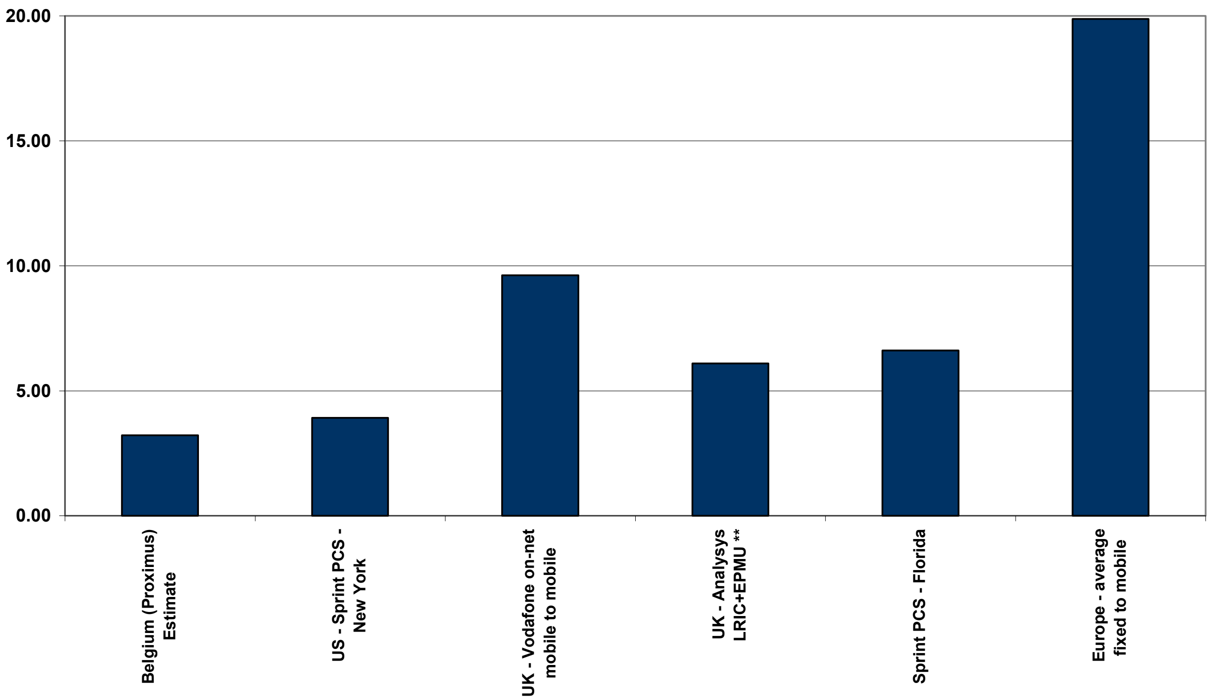
with various estimates of cost-based mobile termination rates. As evidenced in the chart presented below, foreign mobile termination rates in many countries are significantly above best practices. This disproportionate difference cannot be explained by differences in network size, technology, topography, demographics, penetration, income, or any other economical or technical argument. Instead this difference only demonstrate how in many countries rates are unrestrained.

c. Foreign Mobile Termination Rates in many countries are significantly above various estimates of cost-based mobile termination rates

Not only are foreign mobile termination rates in many countries significantly higher than in several other countries, but also the rates are far above all reasonable estimates of cost. A wide range of indicators and analyses suggest that a competitive cost-oriented level for fixed-to-mobile terminations should be around 4 to 7 US cents per minute. The chart below show a range of cost model estimates. Analysys' cost model estimate -- using LRIC+EPMU -- was found to be about 6.1 US cents per minute. All of the cost models listed below include common costs on an Equi-Proportionate Markup (EPMU) basis. Excluding the Proximus estimate (which was based only on limited data and a number of proxy data sources), the cost model estimates range from 3.9 US cents (Sprint PCS in New York) to 6.61 US cents per minute (Sprint PCS in Florida), with the Analysys estimate close to the upper limit of the range at about 6.10 US cents.

Exhibit D

Benchmark Cost Based Estimates and Average Mobile Termination Rates US cents



Note:

*Rate shown is half of the total mobile-to-mobile rate for comparison with termination.

Significantly, even though the Sprint PCS cost models were developed by Sprint PCS with a strong incentive to result in the highest cost figures possible, the figures are still far below current levels in Many Countries. Similarly, the average on-net rates indicated for Spain and the UK are rates actually charged by the MNOs, and therefore are indicative of the MNOs' actual mobile termination costs.

VII. The Commission Must Address the Significant and Increasing Harm to U.S. Consumers and Competition.

Given the obvious detrimental impact that excessive mobile termination rates have on U.S. consumers and competition in the U.S. international services market, the Commission should take steps to address the problem. The Commission cannot rely on market forces alone to address excessive international mobile termination rates because, as explained above, market forces do not exist for mobile termination in CPP markets. If left unchecked, excessive international mobile settlement rates will further undermine the significant success the Commission has had in encouraging competitive cost-oriented fixed line international termination rates. For these reasons, the Commission should take the following steps.

a. The Commission should take a proactive stance in international fora and directly with NRAs

In its ISP Reform Order, the Commission agreed with NTIA that the Commission should "demonstrate U.S. commitment and leadership to achieving lower prices for consumers worldwide." MCI believes that all NRAs should respect the sovereign authority and jurisdiction of their counterparts around the globe. As a basic matter, therefore, MCI believe that the Commission should support and encourage other NRAs in addressing mobile termination issues in CPP settings. However, given the significant and growing harm to U.S. consumers and competition, other NRAs must also respect the Commission's obligation to ensure that U.S. consumers aren't harmed and the Commission's jurisdiction to take action when appropriate to prevent or limit such harms. With these principles in mind, the Commission should be able to work in appropriate multilateral and bilateral fora to ensure that other administrations are considering all relevant elements of the mobile termination issues and taking pro-competitive actions to counteract the problems attached to CPP regimes. Where regulators are undertaking proceedings, the Commission should work with industry and the foreign regulators to ensure that the regulator is fully informed as to the impact of CPP regimes on consumers. Where regulators have not acted, the Commission should take all steps possible to encourage a prompt, thorough, and independent investigations by those NRAs. .

b. The Commission Should Undertake a Rulemaking Proceeding to investigate specific actions that the Commission might consider to protect consumers

As the Commission is aware, the question of international mobile termination in CPP regimes is complex and fraught with sensitivities – both in relation to foreign NRAs and to the domestic mobile industry. There is no easy answer. However, the significant and increasing harm to U.S. consumers and competition resulting from the current market structure obligates the Commission to take what actions it can. Finding the right balance will take considerable focus on details and consideration of specific options. The NOI is providing additional detail to fill out the picture, where possible, of rates, structure, and costs. Unfortunately, the situation is not simple enough that an NOI, alone, will produce answers. It only takes us far enough to see that there is a problem. Creating options and finding balance requires that the rest of the process be undertaken and the Commission move forward to an NPRM.

VIII. Conclusion

High termination charges on mobile networks in countries with CPP regimes result in substantial competitive distortions, leading to an artificial transfer of resources from fixed networks to mobile networks. In addition to increasing the cost of calling a mobile phone beyond economically efficient values, this results in an artificial diversion of economic resources from other sectors of the economy towards mobile networks. It makes little sense to accept market failures in the name of subsidizing some operators over others, particularly when consumers and competition in the industry will suffer the consequences.

Harm to U.S. consumers in connection with a non-competitive market provides the Commission both the obligation and the jurisdiction to take action. Initially, the Commission should engage proactively with foreign regulators and in international fora to encourage appropriate regulatory action to minimize the problem. On a longer term basis, the Commission should pursue this proceeding from this information gathering stage to a stage where the debate can be centered over what actions might be open to the Commission to have a realistic and meaningful affect on the problems at hand.

Respectfully submitted,

MCI, Inc.

January 14, 2005